



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
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CC:SBSE:SWatson
POSTF-152300-01

MEMORANDUM FOR HENRY RECHES
DIRECTOR, ENFORCEMENT S:C:CP:FP:E
Attn: Mark Aronin

FROM: Miriam A. Howe, Manager, General Litigation-Collection
Division Counsel, Small Business Self Employed
CC:SBSE

SUBJECT: State Income Tax Levy Program (SITLP) and Community
Property States

Background

You have requested advice regarding the administration of the State Income Tax Levy Program (SITLP) in community property states. The SITLP program is a method for levying on state tax refunds of delinquent taxpayers. The Internal Revenue Service (Service) provides a database of taxpayers who have failed to pay their federal taxes to various states that have agreed to match the federal database with their state tax refund databases and to forward the state refunds of matching taxpayers to the Service.

The Service has asked the states to research the social security numbers (SSN) of both spouses to a joint return and to honor a levy only when both SSNs are matched to minimize the risk of a wrongful levy. This is currently optional, but you have informed me that the Service will require this in the future.

Wisconsin, which has been a community property state since 1986, is currently in the SITLP program and California will be active in early 2002. The Franchise Tax Board (FTB) of California, which is a community property state, has informed the Service that its system is not set up for dual SSNs and it will not be checking both SSNs because the refund can be taken in satisfaction of the separate tax debt of one spouse. Wisconsin has not objected to the dual match requirement.

ISSUE

Whether a spouse in a community property state with a separate federal tax liability has property or rights to property pursuant to I.R.C. § 6321 in a joint state tax refund so that the Service may levy on the refund?

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CONCLUSION

One hundred percent of a state tax refund which is community property in California and fifty percent of a state tax refund which is community property in Wisconsin, qualifies as property or rights to property pursuant to I.R.C. § 6321 upon which the Service can levy through the SITLP program for the separate liability of one spouse.

ANALYSIS

I.R.C. § 6321 provides for a lien on "all property and rights to property" of a taxpayer. State law delineates what rights or interest a taxpayer may have in property. Drye v. United States, 528 U.S. 49 (1999). Once a taxpayer's interest has been defined, federal law determines whether it "constitutes property or rights to property within the meaning of section 6321" to which the federal tax lien can attach. Id. The issue in this instance is whether a state tax refund constitutes property or rights to property of a married taxpayer in a community property state who has a separate tax liability. 1/ Since Wisconsin and California are of immediate concern, this advice pertains to those two states only. As the other four community property states with state income taxes 2/ come into the program, we will update our advice.

The California Family Code governs community property in California. Cal. Fam. Code § 751 provides that the respective interests of each spouse in community property are present, existing, and equal interests. Cal. Fam. Code § 760 provides that all real or personal property (with some exceptions) acquired by a married person during the marriage is community property. Cal. Fam. Code § 910(a) states, "[e]xcept as otherwise expressly provided by statute, the community estate is liable for a debt incurred by either spouse before or during marriage regardless of which spouse has management and control of the property and regardless of whether one or both spouses are liable." Cal. Fam. Code § 911(a) exempts the earnings of a married person from a debt incurred by that person's spouse before marriage, if the person maintains the earnings in a deposit account to which the spouse has no right of withdrawal and which are not commingled with other community property. The Service views this section as a state exemption that is preempted by Federal law. Therefore, one hundred percent of the non-labile spouse's earnings are available to pay the separate debt of the liable spouse in California. Babb v. Schmidt, 496 F.2d 957 (9th Cir. 1974). Finally, the California

1/ There is no question that the refund from a joint state tax return is subject to the joint federal tax liability of both spouses.

2/ The other four states are Arizona, Idaho, Louisiana, and New Mexico.

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Code provides for the parties to opt out of the community property scheme by written agreement. See Cal. Fam. Code § 1600 et. seq. and § 850. In the absence of a written agreement, the presumption is that all property acquired during the marriage in California is community property.

Rev. Rul. 85-70, 1985-1 C.B. 361, provides the method for calculating how much of a federal tax overpayment from a joint return where the parties reside in a community property state may be applied to the separate liability of one spouse. By analogy, the state tax refund may be treated the same.^{3/} California is most similar to Situation 2 of the revenue ruling. In Situation 2, all community property is subject to the premarital or separate debts of either spouse but is exempt under state law from tax claims. Rev Rul. 85-70 concludes that the entire amount of the overpayment may be applied to the separate liability as we have concluded is the case for the amount of the state tax refund that can be taken by levy in satisfaction of the separate debt of one spouse.

For purposes of the SITLP program, the Service may collect separate tax liabilities of one spouse from that spouse's separate property and from community property. In the event the Service levies on the state tax refund and the parties have signed either a prenuptial or a transmutation agreement, the non-liable spouse can raise the issue by filing a suit for wrongful levy pursuant to I.R.C. § 7426. The nonliable spouse may choose to file an administrative claim for return of wrongfully levied property pursuant to I.R.C. § 6343(b). Treas. Reg. § 301.6343-2 provides directions for making such a claim.

I.R.C. § 6330(f)(2) requires the Service to issue a Collection Due Process (CDP) Notice within a reasonable time after the levy of a state tax refund, but this notice will be directed to the taxpayer. Since the nonliable spouse is not the taxpayer and will not be issued a CDP Notice, that avenue of redress will not be available. The Service has an administrative remedy for an injured spouse, as noted above, when the Service offsets an overpayment of a federal tax payment against a separate tax debt of one spouse. That remedy is also not available as SITLP is a levy situation.

The Wisconsin Marital Property Act ^{4/} has some similarities to the California scheme and some differences. Like California, all property in Wisconsin acquired

^{3/} The type of claim made to the Service by a injured spouse is different from the type of claim that can be filed by a nonliable spouse in response to the SITLP levy. See discussion in our memorandum dated ~~October 25~~ ^{Nov 15}, 2001, regarding Nondebtor Spouse Claims Resulting from SITLP.

^{4/} Wisconsin became a community property state effective in 1986. Some aspects of the statute relating to the effective date are not considered here.

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after marriage is presumed to be marital property. Wis. Stat. § 766.31(1),(2), and (4), but, unlike California, each spouse has an undivided one half interest in marital property. Wis. Stat. § 766.31(3). The parties can also opt out of the community property scheme as they can in California by entering into a marital property agreement. Wis. Stat. § 766.31(10). Pursuant to Wis. Stat. § 766.55(1), debts arising after marriage are presumed to be "family purpose" obligations. In Wisconsin, the Service takes the position that taxes are "family purpose" obligations. This includes one spouse's separate liability for a trust fund recovery penalty. The rationale is that the liable spouse incurred the TFRP while attempting to support the family; therefore, it constitutes a "family purpose" obligation. Since a married taxpayer in Wisconsin has a one half interest in marital property, the Service takes the position that it may levy on one-half of the marital property in satisfaction of the separate debt of one spouse. Vorhies v. Z Management, 87-1 U.S.T.C. ¶ 9200 (W.D. Wis.) (Service levied on one half of non-liable spouse's wages). Following the calculation of Rev. Rul. 85-70, supra, with respect to the state tax refund due, one-half is available to satisfy the levy with respect to the liable spouse. As in California, the remedy for the nonliable spouse is a claim for return of wrongfully levied property or suit for wrongful levy.

In 1995, The General Litigation Division (GL) (now Collection, Bankruptcy, and Summonses Division) gave advice to the District Counsel, Houston, Texas regarding injured spouse 5/ Claims for refund in Texas. (Copy attached.) In that memorandum, GL advised the Texas districts (now areas) to continue to offset joint overpayments in full and to deal with injured spouse claims by reference to the revenue ruling if and when they are filed. Since the Service has no way of knowing in advance which taxpayers have opted out of state community property rules, we suggest a similar course here. 6/ The Service should issue the SITLP levies that take the entire state tax refund in California and Wisconsin and deal with requests for return of wrongfully levied property if and when nonliable spouses file them. 7/

5/ An injured spouse is the nonliable spouse who has not received a refund of federal income taxes because the entire amount has been applied to the federal tax liability of the other spouse.

6/ The SCA dated June 5, 1997, did not analyze the California community property statute and therefore did not acknowledge that a taxpayer who had a written "opt out" property agreement could have a legitimate injured spouse claim.

7/ Filing an administrative claim for return of wrongfully levied property under I.R.C. § 6343(b) and Treas. Reg. § 301-6343-2 is not a prerequisite to filing a suit for wrongful levy pursuant to I.R.C. § 7426. See I.R.C. § 7426(f).

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To summarize, one hundred percent of joint state refunds can be applied to separate tax liabilities in California and fifty percent can be applied in Wisconsin.



Susan Watson is handling the case in this office. Please call her at 202-283-7669 if you have any questions.

(Attachment: Memorandum dated June 26, 1995